



NORTHERN
TRUST

Times of Transition

Economic Outlook for 2022

Summary

The last two years have been unprecedented, in many ways. 2020 witnessed the deepest, but shortest recession in recorded history; 2021 saw an unusual, uneven recovery in which supply struggled to keep up with demand.

We'll enter the new year with the vestiges of the pandemic economy still with us. Normalcy has yet to be regained; more likely, it is being redefined. The following transitions will be critical to performance in 2022:

Living with Covid-19

The first of these is the transition from zero tolerance to learning to live with COVID-19. Since early 2020, the course of the pandemic has determined the course of the global economy and economic policy, and may continue to do so. Happily, COVID-19 is in something of a retreat at the moment, but a cursory reading of the history reveals that viruses of this kind rarely sit still. Vaccination has advanced, but is far from complete.

Given its proven ability to travel with relative ease, COVID-19 anywhere is a threat everywhere. Societies will have to remain vigilant, but will have to accept some level of risk as the price for sustaining commerce.

De-globalization

The second transition surrounds de-globalization. The past two years have illustrated that supply chains are far more brittle than we may have suspected. The pandemic also highlighted the immense dependence that Western nations have on output from China and Southeast Asia. The desire for additional resilience and economic security will drive some production closer to home.

A movement away from unfettered globalization seems well underway; the question is: how far will it go? As the world's economic geography shifts, so will the fortunes of nations. That could produce challenges for debt sustainability and corporate profits, among other things.

The difficult relationship between the United States and China will contribute to economic disengagement. Each accuses the other of slights and transgressions that range from minor to much more serious. Each expects, and in some cases demands, allegiance from other countries, who find themselves caught uncomfortably in the middle.

Ultimately, some level of collaboration between China and the United States will produce the best results for the global economy, and for global society. Almost everyone has a stake in the competition between Washington and Beijing, which can have no clear winner.



Policy Retreat

Policy retreat lies ahead. Fiscal and monetary policy moved with both size and speed to address the challenges presented by the pandemic. With the global still not fully complete, calibrating the retreat from crisis-era measures will be no less challenging. Pulling back prematurely could leave permanent scars; staying too generous for too long could overstimulate. Most economies will be facing fiscal headwinds in the year ahead.

Monetary policy has certainly done its part; to some, it has done more than enough. Inflation has been running well ahead of targeted levels; assessing how it will fare over the longer run is very difficult. Risks to inflation are skewed to the upside; we therefore expect an expanding community of central banks to move away from balance sheet growth and the zero lower bound in 2022. Appropriately previewed and formulated, the retreat should not come at a great cost to market performance.

Drive to Digitize

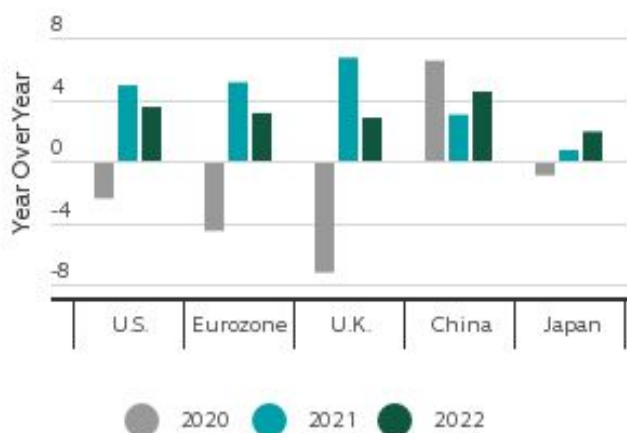
The final transition surrounds the drive to digitize. The pandemic led more of us to do more things more often virtually, accelerating movement down the adoption curve that is unlikely to reverse. The resulting boost to automation and e-commerce is changing cost and pricing structures in ways that we are only beginning to comprehend.

"Technology is certainly changing the nature of work and the skills required to do it."

Technology is certainly changing the nature of work and the skills required to do it. In a digitizing world, those with more modest levels of education will face rockier paths to prosperity. If policy fails to address the disparity, support for economic systems may come under increasing question.

Following are discussions of our outlook for individual markets, with emphasis on how these four transitions will affect them.

Real GDP Forecast (Q4)



CPI: Inflation Forecast (Q4)



Click on the chart to zoom in and explore the data.

Global Economic Forecast – November 2021

	2021				2022				Q4-Q4 % Change	
U.S.	21:1a	21:2a	21:3a	21:4f	22:1f	22:2f	22:3f	22:4f	2021f	2022f
Real GDP (% change, SAAR)	6.3	6.7	2.0	4.7	4.6	4.0	2.9	2.5	4.9	3.5
Inflation (CPI, % change, YoY)	1.9	4.8	5.2	6.5	6.5	5.1	4.2	2.9	6.0	2.9
Unemployment Rate (% average)	6.2	5.9	5.1	4.4	4.2	4.1	4.0	3.9	5.4	4.1
Policy Rate	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.38	0.13	0.38
Eurozone										
Real GDP (% change, SAAR)	-1.2	8.7	9.1	4.0	3.6	3.2	2.9	2.7	5.1	3.1
Inflation (CPI, % change, YoY)	1.1	1.8	2.8	4.2	3.3	2.8	2.0	1.4	4.2	1.4
Unemployment Rate (% average)	8.1	8.0	7.5	7.4	7.4	7.3	7.2	7.1	7.8	7.3
Policy Rate	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Deposit Rate	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
U.K.										
Real GDP (% change, SAAR)	-5.3	23.9	5.3	5.0	3.4	3.0	2.5	2.2	6.7	2.8
Inflation (CPI, % change, YoY)	0.6	2.0	2.8	4.2	4.3	4.5	3.7	2.5	4.2	2.5
Unemployment Rate (% average)	4.9	4.7	4.4	4.6	4.5	4.4	4.3	4.2	4.6	4.4
Policy Rate	0.10	0.10	0.10	0.10	0.25	0.25	0.50	0.50	0.10	0.50
Japan										
Real GDP (% change, SAAR)	-4.2	1.9	-0.5	6.0	2.8	1.9	1.6	1.4	0.7	1.9
Inflation (CPI, % change, YoY)	-0.5	-0.7	-0.2	0.6	0.5	1.1	0.9	0.7	0.6	0.7
Unemployment Rate (% average)	2.8	2.9	2.8	2.7	2.6	2.5	2.4	2.4	2.8	2.5
Policy Rate	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
China										
Real GDP (% change, YoY)	18.3	7.9	4.9	3.0	3.3	3.5	4.0	4.5	3.0	4.5
Inflation (CPI, % change, YoY)	0.0	1.1	0.8	2.3	2.5	2.6	2.4	2.3	2.3	2.3
Unemployment Rate (% average)	3.4	3.4	3.4	3.4	3.7	3.7	3.8	3.6	3.4	3.7
1-Year Prime Rate	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85

a=actual

f=forecast



Watch the video of our economic experts as they address entering the new year with the vestiges of the pandemic economy and the transitions critical to performance in 2022.

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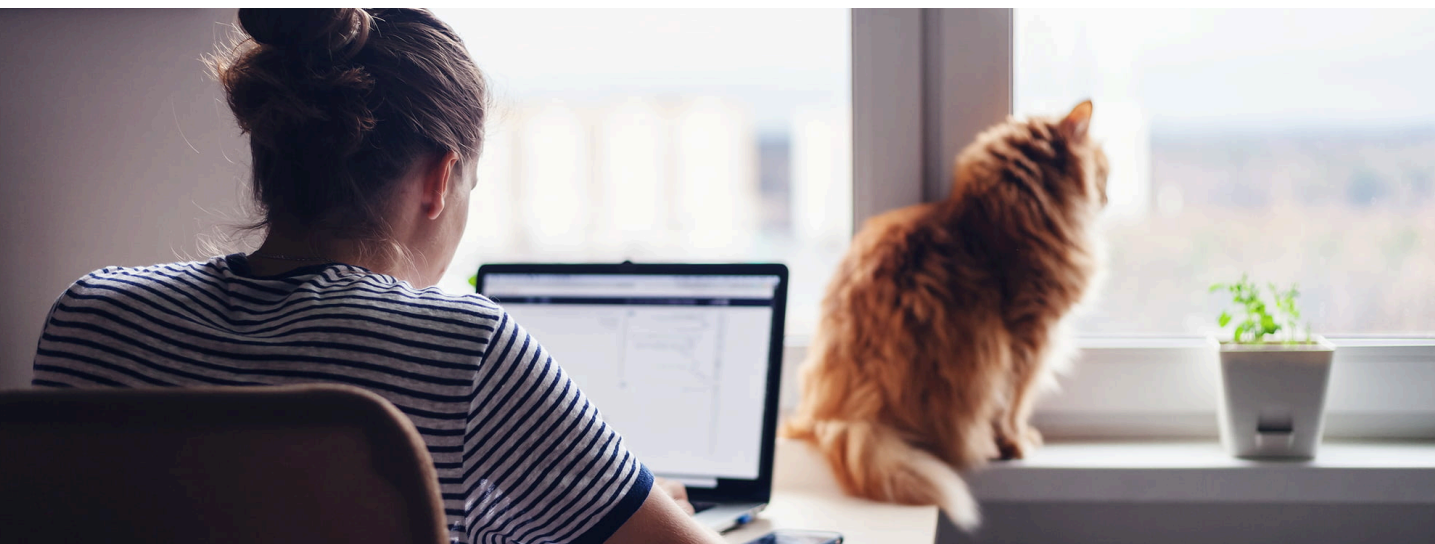
Discover the latest economic insights from our chief economist on social media.



United States

Final readings of 2021 will likely confirm this was the strongest year of economic growth in the U.S. in decades, but it didn't always feel like an outstanding year.





The path of COVID-19 was especially challenging. Optimism reigned in the first half of 2021 as economic restrictions lifted, but then the Delta variant arrived. Vaccination started briskly, but is now proceeding slowly, leaving the nation at some risk of renewed outbreaks.

Leaders in the U.S. can reflect proudly on their decisive policy responses to the pandemic, starting with the CARES Act in March 2020 and continuing through the American Rescue Plan a year later. Support programs for consumers and businesses went beyond any precedent. The outcomes were clear: Most households exited the recession in a stronger position, with more savings and less debt than they had before the crisis. It wasn't easy, but

most businesses survived the pandemic; some adopted new practices and technologies that made them more resilient.

Those supports positioned the economy for a prolonged interval of elevated consumer spending. Most people maintained their incomes but could not spend in their usual patterns, setting the stage for elevated goods purchases. Supply links have

been overwhelmed, and inflation has taken root as more dollars chase limited supplies. We expect inflation will dissipate in the year ahead, but not without elevated concerns about its effect on real incomes.

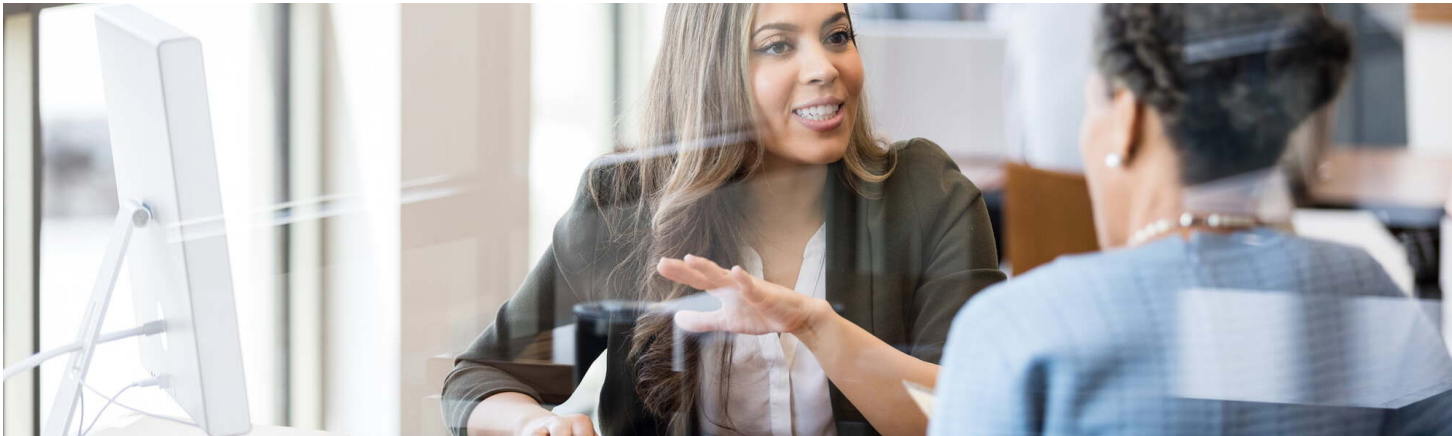
"Progress in the American labor market will be closely watched in 2022."

The year ahead will see fiscal policy shift from emergency measures to long-term investment. Pandemic support programs have expired, and attention has turned to infrastructure and social spending proposals. Infrastructure investment has found bipartisan support, and its approval will help the transition into less generous but steadier government spending. Ideas for social supports were vast, but only a small subset of programs are likely to be approved. The Democratic party is eager to show some legislative gains in advance of a midterm election next year.

The most pressing need for the U.S. economy will be a more complete return to work. The improvement in the unemployment rate masks a

substantial reduction in the workforce. Despite elevated job openings, millions of workers have not returned to employment, for a variety of reasons. Some of these workers enjoyed expanded unemployment benefits, but that program has ceased; any savings cushion will dissipate in due course. Early retirements may not prove permanent, and the availability of childcare is improving.

More consumers returning to work will support steady economic growth. And those workers who



took the pandemic as an opportunity to retrain into higher-value work will reenter with greater skills, a benefit to the broader economy.

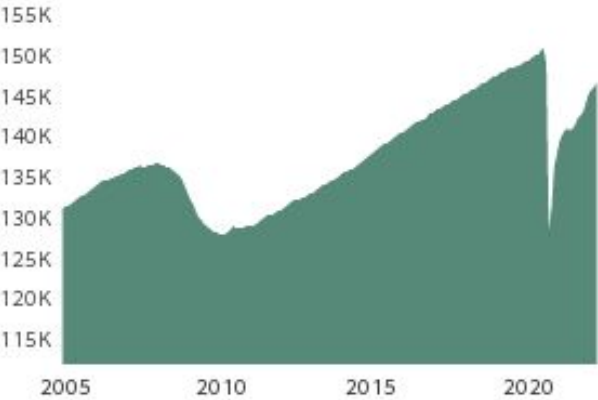
Worries about trade in the U.S. predate the virus, and the return of trade tensions is another sign of a return to normal. The Biden administration has maintained a tough line on China; the business community has diversified suppliers away from China where possible, but re-shoring remains more of a buzzword than a tangible outcome thus far.

Further investments in technology will be needed to support productivity gains. Employers have struggled to hire, especially for lower-wage

workers. From warehouses to restaurants, evidence of automation is growing. Adoption of e-commerce has expanded during the pandemic, and may bring additional discipline to pricing as it proceeds.

The year ahead should bring the U.S. closer to a state of normalcy. Inflation will return below 3% by the end of the year, while gross domestic product (GDP) is forecast to grow by over 3% in the full year 2022. Both of those are higher than their long-run averages, but a step down from the frenetic pace of 2021. Employment will continue growing, prompting the Fed to raise rates from the zero lower bound. After two years of ups and downs, a steadier year will be welcome.

Total U.S. Employment



Sources: Bureau of Labor Statistics, Haver Analytics

Click on the chart to zoom in and explore the data.

China

For better or worse, China has been a leader in the pandemic.





China was the first nation to experience COVID-19, the first to shut down, and the first to return to full economic capacity in 2020. The nation was poised for a year of prosperity in 2021, but it was not to be. China is facing new challenges that will prove persistent in the years ahead.

China's pandemic response has been strict. Lockdowns have been frequent and have continued on a localized basis. Those measures merely fight the virus, but do not prevent outbreaks; unfortunately, China's Sinovac vaccine has underperformed relative to Western formulations. Until the nation improves its vaccine, the virus will play a dominant role in the economy.

China has no time to spare dealing with the pandemic. It remains the world's factory. China's export volumes climbed to record highs in 2021 despite interruptions from quarantines and disruptions across the supply chain. The nation is cognizant of pressure, led by the U.S., for importing nations to reduce their dependence on Chinese goods. The factories that represent so much of the world's productive capacity were financed by debt,

and the nation cannot afford to lose its overseas customers. Fortunately for China, relocating production is an expensive and cumbersome proposition; even if the world realigns, it will play out over a long time span.

"China's policy decisions today may determine its place in the world for decades ahead."

The more immediate risk to China is supply constraints. Ships that cannot unload their goods in Los Angeles or Rotterdam cannot return to take more exports away from China's docks. Surging prices of coal and natural gas are already slowing China's supply of electricity and thus its level of output. These challenges will persist into 2022.

Inflation is a global pressure as we enter the new year, and Chinese producers may seek to raise their prices to recover some of their increased costs—but by doing so, they will only support the case for moving production elsewhere. China's reputation as a least-cost producer has been questionable for some time, and inflation will further impair it.

The Chinese Communist Party appears ready to adapt to a changing world. A policy realignment crystallized in 2021. The leaders of the nation's most successful technology companies were reined in; though the companies remain private enterprises, the influence of the state became clear.

Share of World Exports of Goods



Click on the chart to zoom in and explore the data.

Overheating in China's property markets has long been of concern to external observers, especially as so much domestic saving is wound up in products that fund real estate development. Evergrande's stress suggests the sector has reached its boiling point and will need to cool down. Policymakers will be challenged to prevent excessive losses to domestic savers while not rewarding excessive risk-taking by developers.

"The challenges abound: an energy crunch, insolvent property developers, international tensions and competitive positioning."

The more the world changes, the stronger the case grows for Chinese policymakers to invest further into technology development. For many years, the party has been clear in its intent to move up the value chain, not merely building products but also doing the design and engineering work. The nation's adverse demographics, with relatively few younger workers, will further motivate investment in productivity-enhancing technology. The growth of Chinese brand names suggests the nation's influence is growing around the world. To remain a



competitive force, China will have to continue to support its exports of both products and culture.

Is all this more than the state can handle? The challenges abound: an energy crunch, insolvent property developers, international tensions and competitive positioning. In light of these, we believe China is on a course for slower GDP growth than the rate of 6% or more that was its pre-crisis norm. Executed correctly, this interval of slower growth could put the nation on a path for sustained economic independence. The stakes are high, but the rewards could be substantial.

Eurozone

COVID-19 has been a major headwind for the eurozone economy since early 2020. Fortunately, the link between activity and the virus appears to have been broken by vaccines.





After a shaky start to 2021, the improving health situation accompanied with easing of containment measures have put the bloc's economies back into motion, leading to a strong rebound in growth and employment.

As we turn into the new year, the region's growth momentum is expected to moderate, but will not be weak by historical standards. Real GDP for the euro area is anticipated to grow by over 3% in 2022, putting output only slightly below its pre-pandemic trajectory. Our baseline assumptions rest on the following pillars:

- A close to complete return to normalcy (no major containment measures)
- A gradual resolution of supply bottlenecks related to the pandemic
- Lower but still substantial policy support

With the pent-up gains from reopening mostly exhausted, consumer spending will return to pre-

pandemic patterns as demand moves away from goods and into re-opened services. Consumers will remain the key driver of the economy, benefiting from plenty of accumulated savings, the likely rebound in disposable incomes and reduced uncertainty.

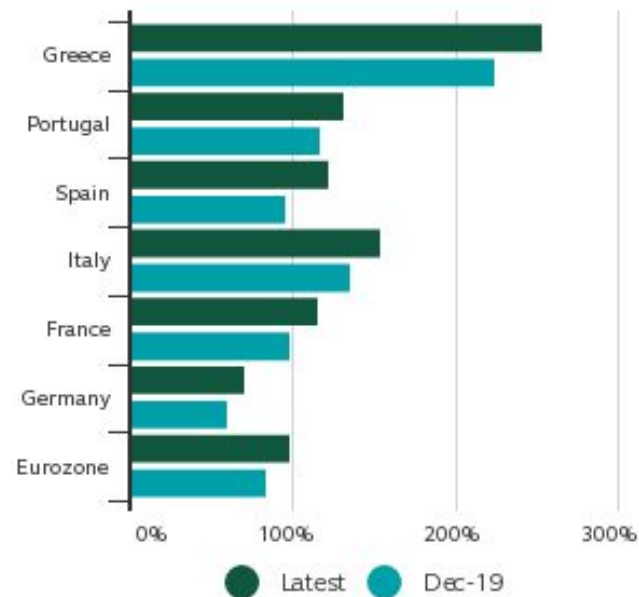
"The eurozone must avoid a repeat of premature austerity"

However, inflation presents a complication. A mix of transitory and technical factors will continue to affect prices well into 2022, with the headline measure likely to hover above 3% year-over-year initially. These factors include a surge in commodity prices (energy, in particular), the impact of supply disruptions, and a reopening-driven rise in the cost of services. As imbalances between supply and demand ease, the rate of price increases should moderate.

The stabilizing economy should allow the European Central Bank (ECB) and national governments to unwind their emergency support programs. We expect the ECB to conclude its pandemic emergency purchase program (PEPP)

as scheduled in March 2022. To prevent tightening of financial conditions, the bank is expected to increase monthly purchases under its ongoing asset purchase program (APP) and use forward guidance surrounding the policy rate to steer the eurozone economy through the post-pandemic period.

Eurozone Public Debt (% of GDP)



Source: Haver Analytics

[Click on the chart to zoom in and explore the data.](#)

Monetary policy will continue to work towards achieving inflation targets, but fiscal support will wane. With the pandemic fading, most national governments will dial back their emergency support measures, leading to notable improvement in budget balances next year. Even though some economic support measures such as furloughs will sunset, robust economic recovery will limit increases in unemployment.

At the same time, suspension of budget deficit caps (outlined in the Stability and Growth Pact) until the end of next year means the governments won't be under pressure to adopt austere policies. The ongoing disbursements from the EU Recovery Fund will also continue to underpin economic recovery.

Leadership within the euro area is in a stage of transition. A German coalition has yet to emerge from September's elections, and the French will be holding a presidential election next spring. Productivity has been one of the weakest links among the eurozone member states. The lasting impact on productivity from the pandemic is not clear. The NextGenerationEU (NGEU) recovery



package is expected to boost investment aimed at making European economies more efficient.

On the trade front, supply bottlenecks resulted in export market share losses for some European economies. Greater emphasis on re-shoring and de-globalization could further disrupt supply chains, weighing on industrial economies like Germany.

The eurozone recovery will remain on track in 2022, but will need more support from policy than other areas of the world.

United Kingdom

The era of de-globalization began in earnest with Brexit. From the moment of that 2016 vote, confusion reigned: How would the separation work, and how would an independent U.K. fare?





Now, more than a year into the separation, we're still not sure. Trade between the U.K. and the European continent grew contentious in 2021 as border inspections proved unworkable. The loss of immigrant labor from the EU, especially lorry drivers, has slowed all parts of the economy.

Prime Minister Boris Johnson has taken the criticisms directly and has stood firm. After leading the nation through the complex negotiation of Brexit, he has remained in place to weather its foreseeable outcomes. It has not been easy; he has

conceded that elevated inflation will be unavoidable in the near term. The past year has brought occasional rumors of a renegotiation of the terms of the Withdrawal Agreement, but such a dramatic move would be costly to the U.K. The

recent relaxation of some of the requirements of the Northern Ireland protocol suggest an appropriate willingness to prioritize today's commerce over yesterday's contracts.

"Five years on, Brexit is still a major issue for the British economy."

British consumers are keeping a stiff upper lip through the turmoil. The referendum to leave the European Union was decided narrowly, as was the referendum to join a generation before. Pandemic supports like furlough payments to maintain employment have expired, and workers appear to be returning smoothly to the labor force. The Conservative Party has historically preferred austere policies, and we do not expect any generous social supports to emerge. While inflation is a risk to all markets, a slower growth pattern could lead to stagflation in Britain. If it sets in, it would be a difficult condition to cure.

The Bank of England stands ready to usher in a new policy era. Among advanced economies, it has been the central bank most eager to signal tightening. In the year ahead, we expect the

cessation of asset purchases to continue in an orderly manner and rate hikes to commence. From its current level of 0.10%, we expect the overnight rate to rise to 0.50% by the end of 2022. Further hikes are conceivable, but would present a risk of overreaction.

U.K. Inflation



Source: Office of National Statistics, Haver Analytics

[Click on the chart to zoom in and explore the data.](#)

Technology will grow more crucial as the U.K. works to maintain its independence. The nation suffered a handful of well-publicized setbacks as factories closed and headquarters relocated in anticipation of Brexit complications. The U.K. cannot offer cost advantages but has an educated and productive workforce that can rise to meet the challenges of a new relationship with the world.

The U.K. can at least celebrate good progress against COVID-19. The country was an early adopter of vaccines and pushed for a “first doses first” strategy that prioritized initial inoculations over full vaccinations. The strategy was effective at reducing mortality. Case growth has come and gone, but the nation’s death rate has held low. The greater insularity of the U.K. will help the nation monitor its arrivals and react to any future outbreaks.

No one expected the U.K.’s transition away from the EU would be an easy change. We expect the year ahead will bring continued economic growth of just below 3% and inflation cooling back to 2.5% by the end of the year, but risks to the downside are growing.



Japan

Tokyo's struggles with the pandemic have delayed its economic recovery. An extended state of emergency has weighed on demand for services and consumption. And it forced the Olympics to be held without spectators.





Fortunately, vaccination rates have been rising since the summer. An improvement in public health conditions, coupled with continued government support, should allow more domestic consumption in the coming quarters.

That said, economic growth in Japan will remain lackluster by global standards, averaging slightly below 2%. Japan's structural woes will continue to hold the economy back. Subdued wage and employment growth will continue to put a lid on demand and inflation. Reflation is a common

theme globally, but inflation continues to elude Japan, despite being a net importer of energy. Entering 2022, higher commodity prices will push inflation up, but it will continue to fall short of the central bank's target.

Headwinds for exports, an important source of revenue for the Japanese economy, have been mounting. With supply chain disruptions likely to last, industrial output will remain weak through the first half of 2022. Japan is well embedded in Asian supply chains, so any disruption in the neighborhood will disrupt Japan. We expect a gradual dissipation of supply bottlenecks and external demand to stabilize, which would deliver a much-needed impetus to Japan's manufacturing exports.

"Even a global inflation wave won't spread to deflation-prone Japan."

However, an accelerated movement away from unfettered global commerce will not bode well for the Japanese economy. The fact that Tokyo will increasingly find itself caught in the middle of tensions between its two biggest export markets, the U.S. and China, could pose further problems.

Apart from technological innovation, Tokyo is also well-known for its stable political landscape. That image has suffered a minor setback as the office of the prime minister (PM) has had three occupants in



just over a year's time. However, a change in leadership won't lead to a drastic adjustment of the current economic policy.

The change in the ruling leadership is unlikely to cause the Bank of Japan (BoJ) to change policy,

even though new PM Kishida does not appear keen on using monetary measures to promote reflation. Although the BoJ has been reducing the size of its asset purchases since March, its yield curve control policy will remain crucial for the government in maintaining flexible fiscal policy.

Japan: Real GDP (Q3 2019=100*)



Source: Haver Analytics

*Q4 2019 GDP contraction due to consumption tax hike

Click on the chart to zoom in and explore the data.

Despite pandemic-induced challenges, Japan is positioned for stronger growth next year. But inflation will continue to prove elusive.

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Emerging Markets

The COVID-19 crisis hit emerging markets (EMs) in different ways.





Although public health and economic conditions are varied across the EM world, the overall setting is steadily improving with the pace of vaccine rollouts accelerating. But coverage still lags advanced nations. We expect GDP in many of these countries to recover strongly in 2022 and take the lead in the global recovery.

Pandemic-induced supply-side constraints will continue to weigh on the performance of export-dependent Asian economies. China's slowdown is another area of concern for not just Asian economies like Taiwan, Singapore, the Philippines and Vietnam, but other resource-rich nations such as Chile and Brazil. All of these countries are tightly connected to Beijing in global supply chains.

Higher commodity prices are a boon for some emerging markets and a curse for others. The recent pick up in commodity prices should bode well for the commodity-dependent Latin American economies. But inflation continues to rise in most of the emerging world because of higher prices for essentials and demand-supply mismatches on the back of economic reopenings. Energy and food

account for a larger share of the consumer price basket in the EMs than in the developed world, and the prices for these essentials are touching multi-year highs. Exporters and factories are struggling with scarce inputs, shipping delays, and chronic port congestion.

"The pandemic has slowed the pace of economic convergence between the advanced and emerging worlds."

Threatened by surging prices and high exchange rate pass-through, a growing number of EMs are tightening monetary policy, risking their embryonic recoveries. Central banks in Brazil, Russia, Mexico, and Chile have already raised policy rates to rein in inflationary pressures, while more countries are likely to follow suit next year.

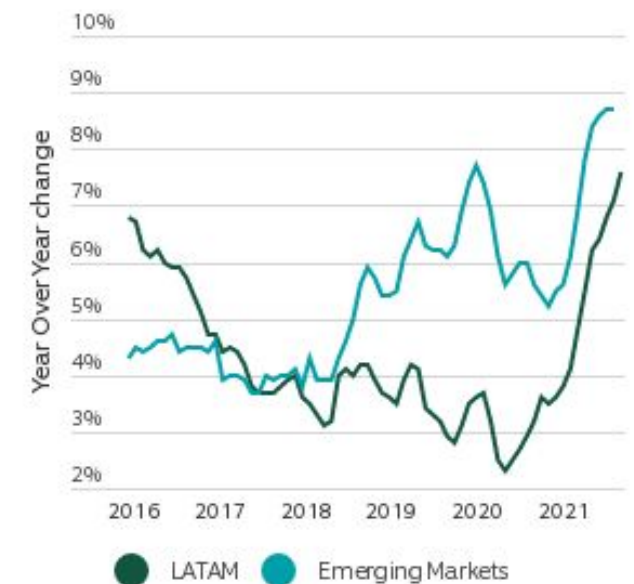
Performance in emerging markets is directly connected to the effectiveness of policymakers in containing the virus and in providing fiscal and monetary stimulus. Broadly speaking, these dynamics are generating the widest gaps among EMs.



Fiscal positions in most emerging markets have weakened significantly during the pandemic. It will be challenging for EM governments to rebuild fiscal space without hampering the recovery. Higher-risk borrowers might take comfort in the exceptionally low global interest rate environment; however,

sustained inflation could force major EM central banks to tighten aggressively next year, pushing debt-dependent nations into distress. A debt crisis would be catastrophic and could trigger political instability, asset price volatility and diminished growth.

Consumer Price Index



Source: Haver Analytics

Click on the chart to zoom in and explore the data.

Continued recovery looks likely, but is not assured for EMs. A worsening pandemic and tightening financial conditions at home or abroad would inflict another hit on developing economies at a time they can ill afford it.

Thank you for reading

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